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No. 87-159

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

REPLY MEMORANDUM

Of Counsel:

GEORGE C. MONTGOMERY
BRUCE M. THORNTON

MONTGOMERY, GASCOU, GEMMILL & THORNTON
1100 Glendon Avenue, Suite 1800
Los Angeles, California 90024
(213) 879-9115

D. DEAN SPARLIN

GIBSON, DUNN & CRUTCHER
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036

*THEODORE B. OLSON
JOHN J. SWENSON
LARRY L. SIMMS

GIBSON, DUNN & CRUTCHER
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500

Attorneys for Petitioner

**Counsel of Record*

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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Because the arguments advanced by respondent in its Brief in Opposition ("Br. in Opp.") are largely irrelevant to whether the federal questions presented by petitioner are substantial and warrant plenary consideration by the Court, petitioner's reply will focus narrowly on the few points warranting a reply.

1. The Eighth Amendment Question

The main thrust of respondent's opposition to the Court's plenary consideration of Question 1 presented by petitioner—whether a punitive fine of $5,000,000 is in violation of the Excessive Fines Clause of the Eighth Amendment—is that petitioner's Eighth Amendment argument is incorrect. Respondent initially suggests, Br. in Opp., at 18-19, that the Court of Appeal may have assumed the applicability of the Eighth Amendment to this $5,000,000 award and, on

that assumption, concluded that this award did not violate the Excessive Fines Clause. The Court of Appeal, however, merely determined that the award was not excessive as a matter of state law, Pet. Cert., App. A, 25a-29a, and, in a separate part of its opinion, declined to inquire whether the award was excessive under the Excessive Fines Clause, squarely holding that the Eighth Amendment "applies only to criminal actions . . . ." *Id.*, at 30a. Thus, this case presents both the question whether the Excessive Fines Clause applies generally to punitive damage awards and the question whether the specific award in this case is constitutionally excessive under that Clause.

Respondent also contends that petitioner's argument that the Excessive Fines Clause applies to punitive damage awards is foreclosed by the Court's decisions in, *e.g.*, *Ingraham* v. *Wright*, 430 U.S. 651 (1977). Br. in Opp., at 20. Respondent's claim cannot be reconciled with *Ingraham* itself,[1] with the Court's identification of this question as raising an "important issue" in *Aetna Life Insurance Co.* v. *Lavoie*, 106 S.

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[1] As the *Ingraham* Court indicated, some types of punishment may be regarded as criminal for purposes of the Eighth Amendment even though not expressly labeled as criminal. *Ingraham* v. *Wright*, 430 U.S. 651, 669 n.37 (1977). Respondent asserts, Br. in Opp., at 20, that punitive damages are imposed to remedy "purely private wrongs," but elsewhere maintains that the award in this case was imposed in connection with petitioner's claims process under which petitioner assertedly tried to "take advantage of *all* policy holders." Br. in Opp., at 3. Respondent cannot have it both ways. In California, as elsewhere, punitive damages are not imposed to compensate the plaintiff but to vindicate the public's interest in punishing a wrongdoer and deterring similar conduct.

Ct. 1580, 1589 (1976), or with the Court's implied grant of certiorari to consider this question in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar. 9, 1987), 107 S. Ct. 1367 (1987).[2]

Finally, respondent suggests, Br. in Opp., at 20 n.6, that this question—squarely resolved by the Court of Appeal—"is not properly before this Court" because it was raised for the first time in the Court of Appeal. This position is without merit. As the Court has held, if a state appellate court decides a federal question, the state court will be viewed as having "necessarily concluded that the federal constitutional question had been properly presented . . . ." *New Jersey* v. *Portash*, 440 U.S. 450, 455 (1975). In addition, decision of the Eighth Amendment question by the Court of Appeal as the highest state court having exercised jurisdiction over this case pretermits any inquiry into the presentation of that question to the state courts. *E.g.*, *Charleston Federal Savings & Loan Ass'n* v. *Alderson*, 324 U.S. 182, 185-86 (1945).[3] In short, the

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[2] The Court's unrestricted notation of probable jurisdiction constitutes an implied grant of certiorari over the Eighth Amendment question presented in *Bankers Life*. *See, e.g.*, *Gent* v. *Arkansas*, 384 U.S. 937 (1966). Respondent's statement, Br. in Opp., at 8 n.2, that Justice O'Connor's denial of petitioner's Application for Stay of the judgment in this case "reinforces" its position that this case does not present a substantial federal question requiring resolution by the Court is refuted by, *e.g.*, the full Court's similar action in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. A-694 (Apr. 7, 1986), 106 S. Ct. 1509 (1986) (denying Application for Stay).

[3] That the Court of Appeal's decision of the Eighth Amendment issue is dispositive of this issue notwithstanding the refusal of the Supreme Court of California to exercise its discretionary

Court's jurisdiction over this question is governed by the "elementary rule that it is irrelevant to inquire . . . when a Federal question was raised in a court below when it appears that such question was actually considered and decided." *Manhattan Life Insurance Co.* v. *Cohen*, 234 U.S. 123, 124 (1914).[4]

2. Imposition of Liability Under a New Legal Standard

Respondent defends at length, Br. in Opp., at 7-19, California's law of bad faith and punitive damages, suggesting that the "California law at issue herein [is] fundamentally different" from Mississippi's law of bad faith and punitive damages involved in *Bankers Life and Casualty Co.* v. *Crenshaw, supra.* Br. in Opp., at 8. Respondent's observation has no relevance to Questions 1 and 3 as presented by petitioner because Question 1 focuses solely on the size of the punitive damage award, *see* note 4, *supra*, and Question 3 is not presented by the appellant in *Bankers Life.*

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jurisdiction over the case is beyond doubt. *See, e.g., Orr* v. *Orr*, 440 U.S. 286, 274-75 (1979) (decision of federal constitutional question by Alabama Court of Civil Appeals established this Court's jurisdiction notwithstanding action of Supreme Court of Alabama declining to exercise its discretionary jurisdiction over case).

[4] Respondent's suggestion, Br. in Opp., at 9, that this case and *Bankers Life* cannot be "equate[d]" for purposes of petitioner's Eighth Amendment challenge to the excessiveness of the punitive damage award at issue is meritless. It is clear that any decision of the Court in *Bankers Life* holding the Excessive Fines Clause to be applicable to punitive damage awards would affect the award in this case. This constitutional question does not depend for its resolution on the state of the substantive law of bad faith in any particular jurisdiction.

Respondent's observation is equally irrelevant to the substantiality of Question 2. Petitioner's Due Process Clause challenge as framed in Question 2 is narrowly grounded in the fact that until the decision below, no California decision had ever imposed upon the issuer of a fidelity bond the legal obligation to indemnify its insured for defense costs as those costs are incurred. As petitioner demonstrates, Pet. Cert., at 17-18, the only California authority expressly discussing the question *when* an insurer's obligation to indemnify its insured under a fidelity bond for the costs of defense arises, *CNA Casualty of California* v. *Seaboard Surety Co.*, 176 Cal. App. 3d 598, 605, 222 Cal. Rptr. 276, 278-79 (1976), states unequivocally that that obligation arises "after liability is established." Respondent does not deny petitioner's assertion, Pet. Cert., at 7-8, that respondent itself expressly agreed in writing that indemnification for defense costs would "properly" await the termination of the lawsuit brought against respondent by the lender. It is thus clear that petitioner's challenge arises out of the making of new California law by the court below.

Petitioner's position is straightforward: under *Gray* v. *Zurich Insurance Co.*, 65 Cal. 2d 263, 54 Cal. Rptr. 104 (1966), and particularly *CNA Casualty of California* v. *Seaboard Surety Co.*, *supra*, it had a reasonable basis to believe that its obligations under the fidelity bond were materially different from those undertaken by an insurer who assumes a contractual duty to defend in a general liability policy. Pet. Cert., at 17-18. Respondent's assertion, Br. in Opp., at 9, that California's law "has been abundantly clear on this point since *Gray* v. *Zurich* was decided in 1966" glosses over the fundamental distinction between a

fidelity bond, under which the insurer undertakes the obligation to indemnify for defense costs with an option to provide a defense, and the duty under a general liability policy to provide a defense in the first instance. Pet. Cert., at 17-18. Respondent's reliance on *CNA Casualty* to support its position typifies respondent's attempt to obfuscate pertinent California law, since the *CNA* court expressly recognized that the "duty to defend is much broader than the duty to indemnify." 176 Cal. App. 3d, at 605, 222 Cal. Rptr., at 278. *None* of the cases relied upon by respondent other than *CNA* purport to determine *when* the obligation of an insurer to indemnify its insured for defense costs arises in California under a fidelity bond.[5] That the Court of Appeal made new substantive law by which it affirmed petitioner's li-

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[5] In addition to *Gray* v. *Zurich* and *CNA Casualty*, respondent, Br. in Opp., at 9, relies on two other cases for the proposition that petitioner's obligations under the fidelity bond were settled at the time its conduct occurred. One case, *Lowell* v. *Maryland Casualty Co.*, 65 Cal. 2d 298, 54 Cal. Rptr. 116 (1966), decided the same day as *Gray*, involved a comprehensive personal liability policy under which the insurer was held to have a duty to defend based on express language in the policy stating that the insurer "shall defend" against suits brought against the insured "even if such suit is groundless, false or fraudulent." 65 Cal. 2d, at 299-300, 54 Cal. Rptr., at 116-17. The other case, *Hartford Accident & Indemnity Co.* v. *Civil Service Employees Insurance Co.*, 33 Cal. App. 3d 26, 108 Cal. Rptr. 737 (1973), also involved an insurance policy under which it was held that there was a duty to defend "even if such suits were 'groundless, false or fraudulent.'" *Id.*, at 33, 108 Cal. Rptr., at 742. These cases involve insurance policies under which the insurer assumes a "duty to defend"; the fidelity bond at issue here contained no comparable language and, until the decision below, no comparable obligation.

ability for bad faith and, therefore, punitive damages, is not open to serious dispute.[6]

Respondent also argues, Br. in Opp., at 21-23, that this question is not properly before the Court because petitioner did not raise it "at the trial level or in its briefs filed in the California Court of Appeal." Br. in Opp., at 22. This argument is meritless. As petitioner pointed out, Pet. Cert., at 19 n.6, this federal question did not mature until the Court of Appeal had departed from the apparent teaching of *CNA Casualty* by holding that the duty to indemnify for legal costs under a fidelity bond is equivalent to the duty to defend under a general liability policy. In such circumstances, petitioner's reliance, Pet. Cert., at 19 n.6, on the doctrine established by *Brinkerhoff-Faris Trust Co.* v. *Hill*, 281 U.S. 673, 677-78 (1930), under which a federal question arising for the first time as a result of the decision of the highest court of a state may be raised for the first time in this Court, is sufficient. Furthermore, under *Pruneyard Shopping Center* v. *Robins*, 447 U.S. 74, 85-86 n.9 (1980), petitioner was not required to present this federal question to any California court by way of a rehearing petition; petitioner, in any event, *did* present this question to the Supreme Court of California, *see* Pet. Cert., at 19 n.6, as the only California court in a position to

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[6] Respondent expressly concedes that the compensatory damage award in this case for breach of contract "was, in pertinent part, based on this ruling . . . ," Br. in Opp., at 9-10 n.3, but simultaneously suggests that the punitive damage award was not based "principally" upon this ruling. Under petitioner's submission, however, *none* of the punitive damage award may be based on the new rule of substantive law laid down by the Court of Appeal.

resolve the apparent conflict between the decision below and *CNA Casualty*.[7]

3. The Absence of Federal Constitutional Protections Afforded Defendants in Criminal Cases

Arguing that punitive monetary fines imposed solely for the purposes of punishment and deterrence—including the $5,000,000 punitive damage award in this case—may be imposed in a civil action, respondent invokes cases in this Court in which this issue was not presented (*e.g.*, *Smith* v. *Wade*, 461 U.S. 30 (1983)), and a California statute which purports to authorize this practice (*Cal. Civ. Code* §3294 (Deering 1976)). Br. in Opp., at 23-24. Respondent, however, makes no attempt to reconcile its position with the decision in *Kennedy* v. *Mendoza-Martinez*, 372 U.S. 144 (1963), relied upon by petitioner, Pet. Cert., at 20, in which the Court struck down a federal statute even though the penalty imposed under that statute served purposes other than punishment and deterrence which might have justified a different result in that case. Under respondent's reasoning, it is *a fortiori* that *Kennedy* could not stand.

Respondent also suggests, Br. in Opp., at 24, that petitioner seeks additional procedural protections be-

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[7] As pointed out by *amicus curiae* California Bankers Association, the California Court of Appeal has routinely upheld the imposition of punitive damage awards in cases, like the instant one, in which liability turned on the resolution of a legal issue of first impression by that court. *See* Br. of the California Bankers Association as Amicus Curiae in Support of the Petition, at 8-9 & n.5. This phenomenon makes the Court's consideration of this question in this case all the more important, because the Court's decision would clearly have a considerable impact on the application by all state courts of new legal standards to sustain punitive damage awards.

cause such protections might result in less excessive punitive damage awards and that, therefore, this question need not be considered because the trial court and Court of Appeal determined that the $5,000,000 award in this case was not "excessive." Petitioner's position, however, is that *no* punitive damages may be imposed in the absence of criminal procedural safeguards because the purposes of punitive damage awards are to punish and deter—the classic purposes of the criminal law. The requirement for such constitutional protections does not depend on the level of punishment imposed particularly where, as here, no meaningful limits have been set by the State on the discretion of juries to punish defendants. Furthermore, and as discussed above, the fact that the $5,000,000 award was determined not to be excessive as a matter of California law says nothing about whether the imposition of *any* punitive damage award comported with the Due Process Clause of the Fourteenth Amendment. The resolution of this question does not depend on the answer to the question whether the award was excessive as a matter of federal or state law.

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Respectfully submitted,

Of Counsel:

GEORGE C. MONTGOMERY
BRUCE M. THORNTON

MONTGOMERY, GASCOU,
GEMMILL & THORNTON
1100 Glendon Avenue,
Suite 1800
Los Angeles, California 90024
(213) 879-9115

D. DEAN SPARLIN

GIBSON, DUNN & CRUTCHER
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036

* THEODORE B. OLSON
JOHN J. SWENSON
LARRY L. SIMMS

GIBSON, DUNN & CRUTCHER
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500

Attorneys for Petitioner

* *Counsel of Record*